



Our First Hundred Years: Fujimoto Bill Broker, Taisho Era

Income Statement Summary

(Millions of Yen)

	fy 2001	FY 2000	% change yoy	fy 2001			
				4Q (1-3)	3Q (10-12)	2Q (7-9)	1Q (4-6)
Operating revenues	109,481	230,735	-52.6%	34,075	27,482	20,965	26,957
Commissions	54,724	73,643	-25.7%	14,112	13,030	14,475	13,104
Brokerage (stock and others)	10,517	13,531	-22.3%	2,649	2,489	2,630	2,748
Brokerage (bond and others)	190	182	+4.8%	69	38	51	30
Underwriting commission (stock and others)	15,716	29,381	-46.5%	3,680	3,228	5,228	3,579
Underwriting commission (bond and others)	8,973	7,914	+13.4%	1,989	1,727	2,647	2,609
Distribution	1,709	3,384	-49.5%	528	479	522	179
Other commission	15,980	19,247	-17.0%	5,188	3,444	3,389	3,958
Net gain on trading securities	26,089	128,934	-79.8%	13,993	3,031	2,449	6,614
Stock and others	14,753	115,403	-87.2%	7,422	5,048	-1,995	4,278
Bond, forex and others	11,335	13,531	-16.2%	6,571	-2,017	4,445	2,336
Net gain on other commodities trading	-	2	-	-	-	-	-
Interest and dividend income	28,667	28,155	+1.8%	5,968	11,419	4,040	7,238
Interest expenses	6,810	12,258	-44.4%	1,528	1,531	1,755	1,995
Net operating revenues	102,670	218,477	-53.0%	32,546	25,951	19,209	24,962
SG&A	90,288	94,993	-5.0%	22,522	20,975	23,950	22,840
Ordinary income (loss)	13,231	123,640	-89.3%	10,209	5,492	-4,834	2,363
Net income (loss)	5,426	70,802	-92.3%	5,266	3,217	-1,759	-1,297
Capital Adequacy Ratio	500.3%	364.7%	-	500.3%	415.8%	469.4%	450.9%

Note: FY 2000 figures have been restated based on the new Japanese uniform accounting standards of securities companies.

Daiwa Securities SMBC

At a Glance

Business

60%-owned joint venture between the Daiwa Securities Group Inc. and the Sumitomo Mitsui Banking Corporation operating in wholesale securities markets in Japan and overseas.

Market Position

Strong in equity trading and bond trading with institutions, bond underwriting and IPOs. Ranks first for IPO listings on 3 emerging equity markets. Market leader in structured finance and derivatives. Growing presence in principal finance and mergers and acquisitions (M&A). First-tier player in equity underwriting.

FY 2001 Results

52% decline in revenues due to severe conditions pertaining in Japanese equity markets. Continued to make progress in other areas including fixed income, structured products, derivatives and M&A.

Daiwa Securities SMBC was originally incorporated as Daiwa Securities SB Capital Markets in April 1999 as a joint venture between the Daiwa Securities Group Inc. and the former Sumitomo Bank, with a brief to participate in Japanese wholesale securities markets. As part of the reorganization of the Daiwa Securities Group, in October 1999 the majority of the overseas subsidiaries were transferred to the new company with the sole exception of the US subsidiary. In April 2001, Sumitomo Bank merged with Sakura Bank to form the Sumitomo Mitsui Banking Corporation. Associated with this merger, Daiwa Securities SB Capital Markets acquired the assets of Sakura

Securities, a subsidiary of Sakura Bank as well as some areas of the investment banking business, including M&A, from Sakura Bank, and was subsequently renamed.

FY 2001 was an extremely difficult year for Daiwa Securities SMBC due primarily to severe conditions applying in Japanese equity markets. Operating revenues fell by more than half to 109.4 billion yen. This was principally due to a sharp downturn in equity trading, which had been the principal driver of Daiwa Securities SMBC's earnings growth during the previous year. Equity trading revenue fell by 87% to 14.7 billion yen in FY 2001. This was compounded by a 47% fall in revenues from equity underwriting to 15.7 billion yen, again due to the poor conditions appertaining during the year, and a 22% fall in equity brokerage commissions to 10.5 billion yen. Improvement in Daiwa Securities SMBC's fixed income operations and in newer businesses such as M&A were insufficient to offset the negative impact of this shortfall.

SG&A expenses also fell by 5% due to a fall in trading expenses and a cut in personnel expenses. But due to the fall in operating revenues, ordinary income was 13.2 billion yen, while net income for the term emerged at 5.4 billion yen.

During the year, Daiwa Securities SMBC was subject to a ratings downgrade by Standard & Poor's, which downgraded its long-term debt from BBB+ to BBB and by Fitch, which downgraded it from A- to BBB+, citing continuing revenue weakness and a deterioration in Daiwa Securities SMBC's profitability. These downgrades did not have much impact on Daiwa Securities SMBC.

Equities

At a Glance

Business

Equity sales and trading with institutional investors.

Market Position

One of the major players in sales and trading of Japanese equities. Together with the retail company, market share on the Tokyo Stock Exchange is close to 10%. Especially strong in large-value off-market and off-exchange transactions drawing on advanced systems support.

Outlook

The need to unwind cross-shareholdings remains, providing opportunities for large-lot transactions.

supports position control and provides traders and salespeople with an advanced end-user computing (EUC) environment. Combined, these functions enable strict real-time position control and quick and accurate pricing. By utilizing these systems, the division has been able to provide competitive execution services to institutional investors.

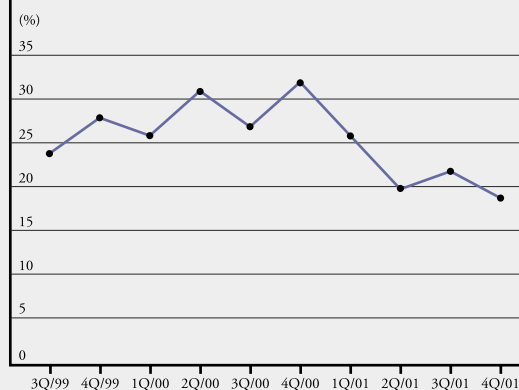
The Equities Division actively pursues opportunities arising from changes in the share ownership of Japanese corporations. The need to unwind corporate cross-shareholdings is facilitated through block trading and placement of shares with institutional investors. These methods enable corporations to unwind shareholdings with limited negative impact on market prices. Daiwa Securities SMBC's global product line, which provides access to both the domestic and overseas networks, is the key to its competitive advantage in this business. The division is also Japan's front-runner in electronic trading. Daiwa Securities SMBC's system utilizes the Financial Information Exchange (FIX) Protocol, the standard for electronic execution of stock transactions by institutional

Background

Daiwa Securities SMBC's Equities Division is one of the leading players in equity trading in Japan, with a strong base in principal trading and IT-intensive services. Daiwa Securities SMBC has firmly established its position, ranking among the leading players in non-auction markets (off-market and off-exchange transactions) as well as trading on the stock exchange. These transactions consist mainly of basket trading and large-lot transactions with institutional investors.

Sophisticated support systems have been developed to take full advantage of the talents and experience of Daiwa Securities SMBC's traders and sales personnel. The order system, which allows for speedy execution of complicated transactions, monitors the market,

Market Share:
Off-exchange and off-floor transactions
(TSE, OSE, NSE)



Source: Daiwa Securities SMBC

investors, and provides overseas institutional investors with the ability to place orders directly with stock exchanges in Japan. Furthermore, transaction reports can be issued through the front office system.

Review

During FY 2001, equity brokerage commission and equity trading gains amounted to 25.2 billion yen, an 80% fall from the previous year's 128.9 billion yen.

The principal reasons for the fall were as follows.

- (1) FY 2000 results were heavily influenced by massive activity by financial institutions and others unwinding cross-shareholdings ahead of the introduction of mark-to-market accounting from April 2001. This activity was particularly pronounced in the fourth quarter of FY 2000 when the Nikkei Average was trading at around 13,000 and when most financial institutions still had latent gains on their shareholdings. Although there was some optimism during the first part of the year stemming from the formation of the reform-minded Koizumi Cabinet, expectations turned to disappointment as progress was not forthcoming. Taken together with uncertainty in the U.S. and the aftereffects of the September 11 terrorist attacks, this led to pressure on the Japanese market which fell to new post-bubble lows. Consequently, demand for large-lot transactions did not match the levels seen one year earlier.
- (2) Although Daiwa Securities SMBC maintained its strong position in basket trading with institutional investors, spreads came under pressure during the year, leading to a fall in profitability.

Market Size (Daily average)			
	Market-wide ^(*)	Sessions of the 3 major exchanges	Non auction ^(**)
	(Billions of Yen)		
FY 2000	1,119.7	831.6	253.7
1Q	1,300.1	954.2	294.4
2Q	1,136.5	823.9	278.3
3Q	935.7	733.9	177.9
4Q	1,105.4	813.5	264.1
FY 2001 (comparison with previous term)	1,001.6 (-10.5%)	768.4 (-7.6%)	211.6 (-16.6%)
1Q	1,108.6	870.0	218.7
2Q	916.3	696.6	203.0
3Q	950.8	721.5	203.7
4Q	1,034.3	787.7	221.8

*1: Whole market = The 3 major exchanges + off-exchange + the OTC market
*2: Non auction = Off-floor for the 3 major exchanges + off-exchange
Source: Daiwa Securities SMBC

Outlook

Demand from clients for services related to unwinding of cross-shareholdings seem likely to remain at high levels. Daiwa Securities SMBC will take advantage of its competitiveness in basket transactions to provide clients with the best solutions to meet their needs, including block transactions. To facilitate this, Daiwa Securities SMBC has implemented a number of organizational changes.

- In November 2001, it established a product headquarters that embraces the bond, equity and derivatives divisions with the aim of improving communication concerning customer needs and the ability to provide hybrid products.
- In February 2002, Institutional Sales Departments 1 (domestic) and 2 (international) were merged to share information about investor order flows.
- In April 2002, the product headquarters established a planning section to allow further integration between products.

Initial Public Offerings

At a Glance

Business

Prepares private companies for IPO, arranges the offering and provides post-offering support.

Market Position

The Japanese IPO market is an oligopoly dominated by the big three brokers Daiwa Securities SMBC, Nikko Salomon Smith Barney and Nomura. The market was lackluster in FY 2001, falling 43% in terms of value from the previous year. Daiwa Securities SMBC maintained its number two ranking on the back of large IPOs conducted for McDonald's Company (Japan) and usen Corp.

Outlook

Although the number of issues is expected to remain constant during FY 2002, a further fall in value terms seems likely. Nevertheless, the business environment for the IPO market is expected to be stable in the long term.

Background

Daiwa Securities SMBC and Nomura, followed by Nikko Salomon Smith Barney, heavily dominate the Japanese market for initial public offerings (IPO) due primarily to their dominance in the retail securities markets. All three market participants identify candidates by having promising, privately-held companies suitable for an IPO referred from a variety of sources including banks, accounting firms, venture capital firms and others. The sponsoring broker provides a variety of legal, accounting, consulting and

other services for an extended period with a view to preparing the candidate for listing. Close relationships formed during this period form the basis for subsequent business as the company grows and makes further equity financing. Historically, Nomura Securities has been the leading company in the IPO market. Over recent years, Daiwa Securities SMBC has been increasing market share and has firmly established itself in second place.

During FY 2001, the number of IPOs remained roughly unchanged from the previous financial year, falling from 201 to 187 issues. However, poor market conditions meant that several previously expected, larger issues were put on hold, leading to a 43% fall in overall market value to 780.4 billion yen. During the year, information technology issues did not enjoy the cachet evident in recent years following the bursting of the dot com bubble and global malaise in that sector. However, successful companies in other sectors could still achieve successful listings as evidenced by the listing of McDonald's Company (Japan) and usen Corp. which were lead-managed by Daiwa Securities SMBC. Other large issues during the year included Nomura Research Institute and Dentsu.

Review

During FY 2001 Daiwa Securities SMBC acted as lead manager in 36 IPOs, with a market value of approximately 260 billion yen, including those for usen Corp. and McDonald's Company (Japan), to achieve number two ranking in both value and volume terms.

Outlook

It seems likely that the Japanese market for initial public offerings will remain roughly unchanged at perhaps 150 to 200 issues while market size continues to fall. As an IPO is the result of long-term preparation, short-term results are difficult to achieve. Furthermore, despite the present situation, the business environment in the long-term is expected to be stable. To date, the relationship with the Sumitomo Mitsui Banking Corporation has lead to Daiwa Securities SMBC obtaining increased participation in issues lead-managed by its competitors. It is expected that the competition with Nomura for the No. 1 spot will continue.

League Table of IPO Underwriters

(Listed date basis)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Nomura	308.1	39.5%	45
2	Daiwa Securities SMBC	267.8	34.3%	36
3	NSSB	80.2	10.3%	32

Source: Daiwa Securities SMBC

Equity Capital Markets

At a Glance

Business

Underwriting of issues and offering of equity.

Market Position

Reasonably strong in small- and mid-sized issues into the domestic market. However, lags both Nomura Securities and Nikko Salomon Smith Barney due to recent weakness in obtaining mandates for privatization issues. Recently appointed lead manager for Japan Tobacco offering.

Outlook

New equity issuance is expected to remain weak in spite of some recovery in the secondary market. Next major issues expected are related to various privatizations. Actively seeking privatization-related issues while also pursuing leads provided by access to the networks of the Sumitomo Mitsui Banking Corporation.

Background

Equity capital markets in Japan are largely dominated by Daiwa Securities SMBC, Nomura and Nikko Salomon Smith Barney and a limited number of foreign securities houses.

Recently, Japanese equity capital markets have been weak due to the malaise in the underlying Japanese securities markets and a tendency to balance sheet restructuring on the part of Japanese corporations. This has been partially offset by the advent of large global offerings, mainly related to privatizations, and

by a boom in demand for IT-related issues. However, both of these offsetting factors were absent in FY 2001 causing the market to contract abruptly.

While Daiwa Securities SMBC retains a strong position in the local market for equity underwriting it nonetheless lags both Nomura and Nikko Salomon Smith Barney in larger global issues. During FY 2002 large privatization offerings for Japan Tobacco (JT), JR East and JR West are planned or have been offered to date. Of these offerings, Daiwa Securities SMBC has been mandated lead manager for the 333,000 government-held share offering of JT.

Review

During FY 2001 the volume of new equity and equity-linked issues by Japanese issuers shrank from 3.5 trillion yen to 0.7 trillion yen. Whereas FY 1999 had seen active issuance from information technology companies and FY 2000 had seen a number of landmark large-scale issues such as NTT DoCoMo and Oracle Japan, FY 2001 was devoid of these supporting factors.

Against this background, Daiwa Securities SMBC managed to obtain a mandate for the 23 billion yen U.S. debut of Nidec Corporation. Furthermore, the simultaneous issuance of convertible bonds and preferred trust securities on behalf of NEC was highly evaluated in the market. The Nidec Corporation deal was voted deal of the year by Thomson DealWatch. Reflecting the above, Daiwa Securities SMBC saw its market share in this area improve somewhat compared with the preceding year. There was no conspicuous increase in business that could be attributed to the parent bank, principally due to the subdued nature of the markets. However, Daiwa Securities SMBC will continue to work closely with the Sumitomo Mitsui Banking Corporation to take full advantage of its expanded client base.

Japanese Corporations' Financing Activities		(Billions of Yen)	
		Number	Amount
Equity	FY 2001	79	725.8
	FY 2000	107	3,580.8
	FY 1999	215	4,603.9
Straight bonds	FY 2001	327	8,078.5
	FY 2000	362	7,573.5
	FY 1999	431	7,554.5
IPO	FY 2001	187	780.4
	FY 2000	201	1,442.0
	FY 1999	126	658.1

Source: Daiwa Securities SMBC

League Table of Arrangers of Equity Offerings in FY 2001				
(Covering deals whose terms were finalized in the year)				
Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Nomura	244.8	33.7%	27
2	NSSB	163.0	22.5%	15
3	Merrill Lynch	107.0	14.7%	2
4	Daiwa Securities SMBC	94.1	13.0%	23
5	UBS Warburg	51.2	7.1%	2
6	Morgan Stanley	25.6	3.5%	1
7	Kokusai	14.2	2.0%	1
8	Deutsche	9.0	1.2%	2
9	Mizuho	5.4	0.8%	3
10	Shinko	4.3	0.6%	5

Note: FY 2001 excludes tracking stock, preferred trust securities and REITs.
Source: Daiwa Securities SMBC

Outlook

Although the Daiwa Securities Group anticipates some recovery in the wider equity markets during FY 2002, it does not expect significant issues of new equity as corporations continue with efforts to rationalize their balance sheets and to raise return on equity to competitive levels. During FY 2002, transactions expected or which have been completed are related to privatization and include listings for the various Japan Railway member companies and for Japan Tobacco. As previously mentioned Daiwa Securities SMBC has been appointed lead manager for the JT offering. Further out, Daiwa Securities SMBC sees significant potential demand from the governmental and quasi-governmental sectors. Daiwa Securities SMBC has formed a dedicated task force to address these business opportunities.

In addition, the division's consultancy business in such areas as debt-equity swaps is increasing as corporations continue efforts to restructure their balance sheets.

Fixed Income

At a Glance

Business

Facilitates the bond trading needs of institutional investors. Underwrites debt issued by corporations and government entities.

Market Position

Top in domestic SB issuance. Well established as number one in terms of customer satisfaction. Benefits from strong systems capability.

Outlook

Demand in the secondary markets is expected to grow as new classes of investors enter the bond markets for the first time. Issuance may continue to be subdued due to lack of need for funds among Japanese corporations.

Background

According to a reputable industry survey by a well-respected U.S. consultancy, Daiwa Securities SMBC has ranked first in client satisfaction for the past three years.

Since the formation of Daiwa Securities SMBC as a joint venture between Daiwa Securities Group and the Sumitomo Mitsui Banking Corporation, this company has been able to improve its standing in domestic straight bond (SB) issuance, to the point where it currently ranks as the market leader. During FY 2001, it also ranked top in SB issuance for the retail securities market.

In its bond market operations, Daiwa Securities SMBC benefits greatly from strong systems support. In particular, Daiwa Securities SMBC is one of only

two companies able to provide real-time online portfolio valuation services via its TOL (Total Bond Analysis Online) system.

League Table of Underwriters of Domestic SBs in FY 2001

(Covering deals whose terms were finalized in the year)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Daiwa Securities SMBC	1,893.2	23.4%	92
2	Nomura	1,658.0	20.5%	75
3	NSSB	1,096.0	13.6%	53
4	Tokyo Mitsubishi	966.0	12.0%	46
5	Mizuho	933.8	11.6%	54
6	UFJ	554.1	6.9%	25
7	Goldman Sachs	296.5	3.7%	14
8	Morgan Stanley	158.8	2.0%	12
9	Shinko	151.5	1.9%	15
10	Merrill Lynch	82.0	1.0%	5

Source: Daiwa Securities SMBC

League Table of Underwriters of Domestic SBs for Sale to Individual Investors in FY 2001

(Covering deals whose terms were finalized in the year)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Daiwa Securities SMBC	400.8	33.3%	21
2	Nomura	397.2	33.0%	21
3	NSSB	276.0	22.9%	10
4	Shinko	53.0	4.4%	5
5	Kokusai	30.0	2.5%	3
6	UFJ	20.0	1.7%	2
7	Tokyo Mitsubishi	10.0	0.8%	1
8	Tokai Tokyo	10.0	0.8%	1
9	Mizuho	4.0	0.3%	1
10	Mizuho International	3.0	0.2%	1

Source: Daiwa Securities SMBC

Japanese bond markets have been affected by a number of changes over the last several years. Mark-to-market accounting for financial instruments was introduced in April 2000, while real-time gross settlements for government bonds was introduced in January 2001. From April 2002, blanket deposit insurance on bank time deposits ended, with similar deposit insurance on cash deposits to follow in April 2003. This has caused a number of types of investors, normally averse to investing in risk assets, to reconsider their attitude. The market is also seeing Zaito agencies starting to tap bond markets for the first time.

Review

Distribution & Trading

During the year under consideration, major market influences included a succession of 11 straight US rate cuts, the Argentinean debt crisis and the bankruptcies of Enron and Mycal, a large supermarket chain in Japan. This in turn led to a great deal of risk-aversion among investors, with companies having lower ratings finding it increasingly difficult to issue new debt. Furthermore, with expectations for economic recovery under the Koizumi Cabinet running low, investors have become even more conscious of taking credit risk.

Against this background, bond and forex trading revenue fell by 16% to 11.3 billion yen.

In advance of the ending of blanket deposit insurance on bank accounts, there were signs of a major increase in interest in fund allocation among many investor groups. Individuals invested actively in foreign currency bonds. Meanwhile, local authorities started to divert funds from banks to the bond markets. Other classes of risk-averse investors including schools, religious organizations, foundations and similar organizations are following the same path.

On top of this, there was continued strength in demand for structured bonds in light of the low interest rate environment. Conversely, straight bond issuance was subdued, particularly for issuers rated lower than BBB, as investors sought refuge in credit quality.

Bond Underwriting

Underwriting commissions on bonds increased by 13% to 8.9 billion yen, comfortably outpacing the flat performance recorded by the market as a whole, as Daiwa Securities SMBC was able to increase its market presence with the help of the Sumitomo Mitsui Banking Corporation. Access to clients through the networks of the former Sakura Bank was one reason for the increase in market share.

Other major developments during the year included the commencement of SB issues by the Zaito agencies. Daiwa Securities SMBC managed to secure a major position in the issuance of Zaito bonds, handling 105 billion yen as lead manager out of a total of 580 billion yen issued during the year. In addition, there was a trend among some companies to appeal to the retail market in order to diversify the investor base and as a vehicle to promote investor relations.

Underwriting commission rates continued to fall during the year, especially for sought-after AAA-rated issues and, for these issues, have now fallen to rates applicable on the Euro markets. In Daiwa Securities SMBC's opinion further falls are unlikely during FY 2002.

Outlook

Daiwa Securities SMBC expects the end of blanket deposit insurance for bank deposits to have a major knock-on effect on Japanese bond markets. Already, certain classes of investors such as local municipalities are starting to diversify their risk exposure by shifting

funds from deposits to government bonds and highly rated straight bonds. Daiwa Securities SMBC expects this trend to spread to other investors such as local public organizations, schools, foundations and religious organizations. In addressing demand from this source, exploitation of Daiwa's nationwide branch network will be a source of competitive advantage as will cooperation with the networks of the Sumitomo Mitsui Banking Corporation.

Given that the low interest rate environment is likely to continue through FY 2002, Daiwa Securities SMBC confidently foresees continuing growth in demand for structured bonds. Links between the Fixed Income and Derivatives & Structured Financial Products Departments will be strengthened to maximize Daiwa Securities SMBC's ability to offer market-leading solutions and further expand its market lead in this area.

In its underwriting activities, Daiwa Securities SMBC expects demand to remain at around current levels. However, the actual level of demand likely to be seen is somewhat dependent on the market's appetite for risk during the year since electric power, trading, consumer finance and steel companies each have major debt redemption scheduled for FY 2002. Continuing high levels of risk-aversion might well push issuers to seek alternative methods of financing.

Finally, Daiwa Securities SMBC will continue to place much emphasis on foreign currency bonds for the retail channel, a trend which started in FY 2001, in expectation of demand from that channel for higher-yielding instruments and currency diversification.

Derivatives

At a Glance

Business

Creation and distribution of interest rate, currency, and equity derivatives and alternative investment products.

Market Position

Market leader in Japanese derivatives markets. Integrated equity, interest rate, and currency derivative operations provide a significant competitive edge. Strong systems capability underpins advanced product creation. Innovative Enman-Sai bonds a blockbuster hit in FY 2001.

Outlook

Although business outlook is to some degree dependent upon movement in underlying securities markets, another year of brisk growth seems likely, due to the continuing low interest rate environment and the lifting of blanket guarantees on bank deposits.

Background

The Derivatives & Structured Financial Products Department of Daiwa Securities SMBC ranks as a leading player in Japanese derivative securities markets. In particular, for several years it has been voted number one in terms of customer satisfaction in several crucially important areas of the market, according to a respected U.S.-based consultancy.

Review

Department revenue recovered swiftly from year-earlier levels, which had been depressed due to a poor performance from equity derivative trading.

Interest Rate Derivatives

Revenues from interest rate derivatives fell by more than 38% compared with the previous year due to limited needs to hedge outstanding positions in the low interest rate environment and difficulty predicting interest rate trends.

Currency Derivatives

Because of low returns available on domestic fixed-income products, there was great interest during the year in foreign-currency bonds. Consequently, the market for currency derivatives was active. Much of this demand came from banks, traditionally competitors of Daiwa Securities SMBC in this area, due to its superior structuring capability for the requisite advanced exotic products. Revenues grew 76% year-on-year.

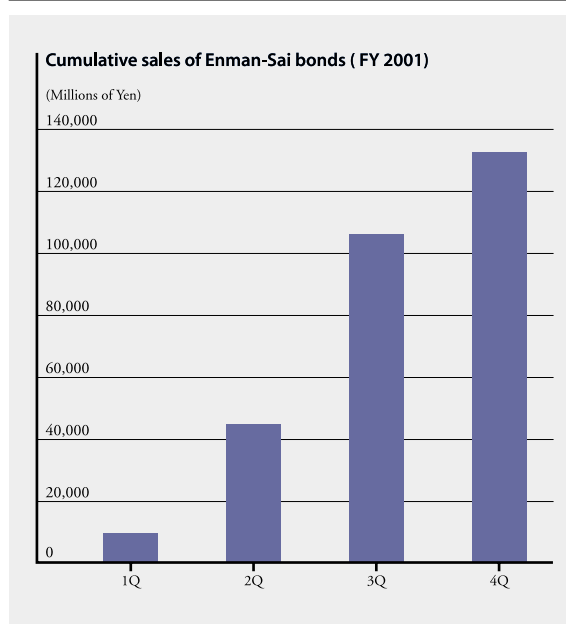
Equity Derivatives

During the year, the department developed the so-called Enman-Sai bond. This is a structure including guaranteed principal but allowing the holder to participate in any rise in the Japanese equity markets in the form of enhanced coupon payout. This product was targeted at institutions such as regional banks, where it was well received. It has also proved extremely popular with corporations and with certain segments of the retail securities market. During the year, Daiwa Securities SMBC issued Enman-Sai bonds with a face value of 130 billion yen. Due to the hybrid rates-equity nature of the product and the technology needed to hedge such structures, Daiwa Securities SMBC was able to maintain exclusivity on the product for more than six months compared with the near

instantaneous replication by competitors usually exhibited in Japanese derivative markets. Due to the success of Enman-Sai bonds, the department's equity derivative revenues rose more than 657% compared with the depressed revenues seen during the previous year.

Structured Bonds

Similarly, revenues from structured bonds, historically a mainstay of the operation, rose more than 14% due to the success of Enman-Sai bonds.



Alternative Investments

After a period of careful preparation, the department started to promote alternative assets from July 2001. Sales in FY 2001 came to 12 billion yen, including private investment trusts and fund of funds-linked products guaranteeing principal and incorporating fund-of-funds managed by a leading U.S.-based asset manager. Daiwa Securities SMBC is convinced that this business has substantial long-term potential outpacing that of structured bonds over the next two to three years.

In February 2002, the department underwent an extensive systems upgrade, with the introduction of a new system for equities derivatives. The new system is destined to play a central role in further enhancing Daiwa Securities SMBC's strength in this area.

Outlook

Business opportunities for equity derivatives expanded due to the depressed equity market and the increase in volatility. On the assumption that Japanese equity markets continue to show a modest recovery into FY 2002, equity derivative markets should show continuing strength, especially should financial institutions continue to unwind their cross-shareholding positions.

Further strength in structured bonds can also be confidently predicted due to a lack of alternatives in the current low interest rate environment. The termination of blanket deposit insurance coverage on bank accounts will also have a stimulative effect here. Finally, the department believes that continuing interest in foreign currency bonds will lead to increasing demand for currency derivatives.

Structured Finance

At a Glance

Business

Structuring and marketing of structured products, including those related to real estate and financial claims.

Market Position

Strong in asset-backed securities (ABS), ranking second to Mizuho Securities. Noted for its innovative product development capabilities, with a long line of industry firsts to its credit, backed by strong nationwide distribution. Especially strong in securitization of financial claims and real estate.

Outlook

Continued long-term growth building on an application of securitization to a wider range of asset classes.

Background

The Japanese market for structured financial products was largely promoted by legislative changes happening as a part of Japan's "Big Bang" deregulation in the closing years of the last decade. Since that time, securitization markets have deepened and widened, embracing an ever-increasing pool of asset types. Daiwa Securities SMBC has been a leader in this market since its inception and has contributed to its development. Daiwa Securities SMBC ranks second in the ABS market behind Mizuho Securities in terms of total amount lead managed, according to a survey conducted by Thomson DealWatch, drawing on its

competencies in the area of advanced structuring and depth of distribution reaching every corner of Japan.

Although authoritative statistics on this market are not available because of the large number of private placements, Daiwa Securities SMBC estimates that total market size expanded from approximately 2,500 billion yen in FY 2000 to 3,000 billion yen in FY 2001. During FY 2001, securitization of financial claims made especially strong progress, driven by the securitization of assets owned by failed life insurance companies, while consumer finance companies started to take advantage of recent regulatory changes to more actively use securitization in their funding strategies. Real estate-related securitization also made progress, particularly in the area of RMBS (Retail Mortgage-Backed Securities), as the Housing Loan Corporation started active securitization and as the Resolution and Collection Corporation (RCC) started to use securitization as way to deal with bad debt. In the area of CMBS (Commercial Mortgage-Backed Securities), assets subject to securitization expanded from the historic mainstay of office buildings to other property classes including hotels, malls and other types, with Daiwa Securities SMBC introducing a number of innovative structures.

FY 2001 was also notable as the year in which the REIT (Real Estate Investment Trust) market was inaugurated in Japan. Three large-scale issues were made during the year. Market reaction to these deals was tepid, causing a number of pending transactions to be postponed. However, a modest market recovery could allow the available market to climb to 500 billion yen in as little as one or two years. Daiwa Securities SMBC expects the REIT market to show further expansion in the long term as it becomes an important financing tool for real estate developers.

Review

Against this background, Daiwa Securities SMBC completed 11 transactions involving financial assets, worth some 238.6 billion yen, during the financial year. Highlights of these were as follows.

- In June 2001, Daiwa Securities SMBC arranged the issue of 50 billion yen in securitized receivables for the consumer finance company QUOQ, of which 10 billion yen was placed with individuals, a first in Japan.
- During FY 2001 Daiwa Securities SMBC arranged the first ever securitization of maintenance lease assets for NEC Leasing.
- In February 2002, Daiwa Securities SMBC raised 30 billion yen for QUOQ using the master trust program. Issued with a maturity of 10 years, these notes have the longest maturity ever achieved for credit receivables in Japanese securitization history.
- Daiwa Securities SMBC was bookrunner for the first issuance of residential mortgage-backed securities issued by the government Housing Loan Corporation, raising 50 billion yen in the first half of FY 2001.
- In FY 2000 Daiwa Securities SMBC securitized “kikin” funds for the Nippon Life Insurance Company, an industry first. During FY 2001, Daiwa Securities SMBC consolidated its lead in this area by securitizing such funds for Fukoku Life Insurance and Yasuda Life Insurance.

Daiwa Securities SMBC was also active in real estate securitization, completing a total of 5 transactions, worth 429.6 billion yen during the year. Highlights in this category include the following.

- The RCC started to use securitization as a way of disposing of real estate held. Daiwa Securities SMBC was lead manager for the first issue.
- Daiwa Securities SMBC securitized an office building owned by KDDI in a 190 billion yen issue, the largest real estate-related securitization ever in Japan.
- Daiwa Securities SMBC securitized the first building still under construction (on behalf of Recruit Cosmos).
- Daiwa Securities SMBC lead managed Orix JREIT, Inc., listed in June 2002.

Outlook

Daiwa Securities SMBC expects stable growth in this area over the next several years as an increasing range of assets become subject to securitization. Daiwa Securities SMBC will continue to hone its advanced structuring skills and strong distribution to maintain a position of market leadership in this area.

Japanese ABS Market	FY 2001		FY 2000	
	Amount		Amount	
	(Billions of Yen)		(Billions of Yen)	
Lease	396.4	15.0%	265.1	15.1%
Credit Card	361.5	13.7%	393.4	22.4%
Consumer Finance Loans	540.7	20.5%	46.6	2.7%
Residential Loans	322.4	12.2%	223.6	12.7%
Collateralized Debt Obligation (CDO)	277.0	10.5%	128.0	7.3%
Real Estate	643.4	24.4%	458.3	26.1%
Other	96.5	3.7%	243.9	13.9%
Total	2,637.8	100.0%	1,758.8	100.0%

Source: Daiwa Securities SMBC

FY 2001 League Table of Combined ABS Bookrunners				
Ranking	Securities company	Amount (Billions of Yen)	Share	Number
1	Mizuho Securities	604.2	22.9%	21
2	Daiwa Securities SMBC	502.2	19.0%	18
3	Morgan Stanley	381.5	14.5%	5
4	UFJ Capital Markets	272.7	10.3%	5
5	Nomura Securities	229.4	8.7%	6

Source: Thomson DealWatch

Principal Finance

At a Glance

Business

Takes principal positions in assets that are non-standard for a Japanese securities company, such as financial claims and, more recently, real estate and private equity (alternative assets).

Market Position

Although independent comparative information does not exist, has ranked among the top few companies in this market sector since starting business in 1997, initially by acquiring non-performing assets in bulk transactions from financial institutions such as regional banks. Separated from Structured Finance Department in FY 2000 due to expansion in business. Formed Daiwa Securities SMBC Principal Investments Ltd. as a separate company to formally enter real estate-related and private equity business. Expanding scope of business by forming alliances. Established fund management company with GE Capital and Sumitomo Corporation in the field of MBOs and private equity while operating a fund with Wilbur Ross in corporate rehabilitation.

Outlook

Business should grow as Japanese financial institutions dispose of distressed assets and corporations accelerate restructuring efforts.

currently expanding amid the major reforms being instituted in Japan's corporate and financial sectors, such as the rationalization of balance sheets and restructuring, which has led to an expansion of disposals of real estate and other assets amid the revitalization of company operations. In the field of private equity investment, typified by MBO/LBO, numerous funds targeting Japan are being created.

During this period of reform encompassing the corporate and financial sectors of Japan, the needs of companies to sell off corporate assets and operations will probably continue to increase. Consequently, the importance of establishing alternative asset investment operations to provide risk financing for these needs will also increase. For this reason, the Daiwa Securities Group intends to expand operations in this field through Daiwa Securities SMBC Principal Investments.

Review

This operation has hitherto targeted financial claims, including non-performing loans. In FY 2001, the range of assets targeted was expanded to include such activities as direct investment in real estate and corporate turnaround situations.

To advance these operations, Daiwa Securities SMBC Principal Investments, a wholly-owned subsidiary of Daiwa Securities SMBC, was established with an investment limit of 50 billion yen, and commenced operations in October 2001. In addition, the asset portfolio managed by Daiwa Securities SMBC was repatriated from the Cayman Islands to Tokyo and the Cayman subsidiary was closed.

As the first project in the area of corporate revitalization, Daiwa Securities SMBC acquired, in December 2001, a capital interest in the bankrupt Nikko Electric Company (an autoparts company, formerly listed on the second sector of the TSE) in a

Background

These operations were originally initiated to meet the needs of financial institutions to quickly address the problem of non-performing loans. Activities are

joint operation with Wilber Ross of the U.S. The department has also expanded activity in such areas as advisory operations for revitalizing private-sector firms, and provided DIP (Debtor in Possession) financing (provision of funds to rebuild the operations of companies under legal liquidation) to Mycal.

In other operations, Daiwa Securities SMBC has conducted direct investment in various types of real estate totaling about 60 properties through purchases of real estate portfolios from sellers including financial institutions. Daiwa Securities SMBC also plans to resell real estate investments to retail investors and to increase the value of real estate by acquiring tenants and investing in equipment. Another planned activity involves providing finance by means of non-recourse loans and securitization.

Continuing to expand its operations in the bulk sale of non-performing loans, Daiwa Securities SMBC conducted more than 90 transactions with financial institutions and other firms in FY 2001. Daiwa Securities SMBC now ranks in the top echelon of firms in this area, completing more than 300 such transactions and conducting business with a majority of banks including regional and second-tier banks.

Outlook

Daiwa Securities SMBC believes that the revitalization of debt-burdened companies will be the major focus of attention in FY 2002. It also believes that businesses relating to company revitalization, such as purchases of loans of nearly bankrupt companies, debt-equity swaps, company revitalization funds and DIP finance will expand substantially.

Daiwa Securities SMBC also believes that with the shift toward mark-to-market accounting, the need to dispose of real estate and other assets will increase, and that MBO/LBO and other private equity investments

relating to corporate reorganization will expand.

Amid this environment, Daiwa Securities SMBC plans to invest aggressively in a variety of assets and companies, with both its own funds and funds raised from others.

M&A

At a Glance

Business

Provides business support and advisory services related to mergers and acquisitions in Japan and overseas.

Market Position

Ranked number four (based on transactions closed) in the industry in 2001 on the strength of involvement in merger of Sumitomo Bank and Sakura Bank. Stable growth in domestic small-sized transactions, due to introductions from the Sumitomo Mitsui Banking Corporation. Attempting to improve its position in large-scale, cross-border M&A through a strategic alliance.

Outlook

Continuing steady long-term growth stemming from reorganization of corporates and the disposal of non-performing assets by the banking sector.

Background

Historically, the banking sector has acted as custodian of corporate governance in Japan using leverage acquired as a result of its lending activities and privileged access to client information to promote managerial or financial reform at client companies on an as-needed basis. As reorganization of the banking

sector has progressed in the teeth of deflation and mounting bad debts, banks have lost both the will and the capacity to internalize this process and have sought assistance from external parties. The result has been a sharp increase in activity in the Japanese market over the last several years.

According to a survey by Thomson Financial, M&A activity in the Japanese market during FY 2001 fell by 43% compared with 115.4 billion dollars recorded the previous year, to 65.9 billion U.S. dollars (approximately 8.6 trillion yen), the lowest level since the survey started. Large-scale M&A activity in the financial and communications sectors appears to have run its course. However, traditional sectors such as iron and steel and pharmaceuticals picked up some of the slack, as evidenced by the formation of JFE Holdings through the merger of NKK and Kawasaki Steel, and the merger of Chugai Pharmaceutical with Roche of Switzerland.

Weak M&A activity was also evident on a global level. The worldwide total of publicized M&A deals dropped by almost one half from 3.4 trillion dollars (approximately 450 trillion yen) to 1.7 trillion dollars (approximately 226 trillion yen), with Japanese M&A accounting for 3.8% of this total.

Another feature of note during FY 2001 was increasing signs of maturity in the M&A market, with corporate management increasingly considering M&A earlier in the restructuring process. In addition, the use of legal proceedings in respect of failed companies is growing in popularity. Nevertheless, Japanese markets still lag those of the United States by many years in this respect.

Review

Against this background, the department closed 56 transactions, or approximately 2.8 trillion yen, during FY 2001. Due to the concentration of deals closed at the end of March 2001, the beginning of FY 2001 was mostly dedicated to marketing. Although the M&A

Ranking of M&A Advisors (Calendar Year 2001)

Ranking	Advisor	Amount (Millions of Dollars)	No. of deals
1	Goldman Sachs	94,010	22
2	Nomura	57,713	61
3	JP Morgan	56,618	21
4	Daiwa Securities SMBC	48,482	34
5	Merrill Lynch	32,464	11
6	Salomon Smith Barney	28,739	29
7	Morgan Stanley	25,675	15
8	Mizuho	21,742	82
9	CSFB	17,485	9
10	Lehman Brothers	17,130	7

Source: Thomson Financial

team from the former Sakura Bank contributed to these efforts, revenues for the first half declined year-on-year. However, the department was able to shake off the severe environment to come back in the second half.

Approximately 60% of deals were sourced from the networks of the Sumitomo Mitsui Banking Corporation. A further 15% were sourced from the networks of the Daiwa Securities Group, while the balance was self-generated.

The department was strengthened by the inclusion of a number of qualified staff from the M&A team at the former Sakura Bank. This group brought in a number of complementary skills, especially experience in dealing with bankrupted transactions, an area in which Daiwa Securities SMBC has historically been under-represented. Inclusion of these new resources brought the number of staff employed in the department to 67.

Daiwa Securities SMBC signed a nonexclusive memorandum of understanding with the U.S.-based M&A specialist Lazard Freres in FY 1999. This memorandum gives Daiwa Securities SMBC access to the global reach and industry expertise of its partner while allowing Lazard access to a strong Japanese partner to complement its solid position in the U.S. and Europe. During FY 2001, earnings from this quarter were minimal, largely due to the fact that a large number of deals were completed at the end of the previous financial year and to the fact that business in cross-border M&A was quiet during FY 2001, especially after the events of September 11th.

Outlook

Japanese corporations are likely to accelerate movement to corporate reform making use of divestitures and acquisitions driven forward by the process of bad debt disposal by the banking sector. In

the face of declining opportunities in large-scale transactions, most market participants, including European and American banks, are shifting the focus of their operations to medium-sized deals. For the current year, Daiwa Securities SMBC will try to compete by making maximum use of its own networks and increased cooperation with the relationship management division and the other departments in the investment banking division, as well as those of the Sumitomo Mitsui Banking Corporation and Lazard.

Overseas Network

At a Glance

Business

The Daiwa Securities Group operates from a network of 19 locations in Europe and Asia. With the exception of the North American subsidiary and operations unrelated to securities, all overseas operations are structured as subsidiaries of Daiwa Securities SMBC.

Market Position

Daiwa Securities Group's overseas network is smaller than those of its closest rivals although equipped to support the Group's goals going forward.

Outlook

Expected domestic demand for foreign-currency denominated bonds in FY 2002 will highlight the value of the overseas operations. For the immediate future, the Group will continue to stress careful augmentation of its overseas presence in support of the management paradigm. Longer term, the Group looks to China for new growth opportunities.

Background

The Daiwa Securities Group has established a strategy of careful and incremental building of its overseas capabilities to strengthen the Group's core competencies in Japanese securities. During FY 2000, the re-opening of the Madrid and Milan branch offices, primarily to support Daiwa Securities SMBC's equity operations, and a rebuilding of the fixed income origination and syndication operations based in London, were evidence of this. During FY 2001, there were no significant changes, although headcount again expanded.

Review

During FY 2001, assets acquired through the bulk sale business by the group's Cayman subsidiary were transferred to Daiwa Securities SMBC Principal Investments, established in October 2001. Reflecting this situation, Daiwa Securities SMBC recorded a 55% fall in ordinary income to 7.8 billion yen in its overseas operations, including subsidiaries of the Holding Company, during FY 2001. In other areas, Asia slipped into loss due to its reliance on Japanese equity business, while the European operations saw an increase due to domestic demand for foreign-currency denominated bonds.

Outlook

Daiwa Securities SMBC believes that the overseas operations are fully capable of meeting demands made

on them, mainly involving cross-border businesses involving Japanese securities or in satisfying domestic demand for foreign securities. Consequently, it will continue to make incremental improvements to the overseas operations to support the current management paradigm, taking into account an expected increase in domestic demand for overseas securities during FY 2002.

Further out, Daiwa Securities SMBC is committed to participating in the potential of the rapidly-evolving securities market in China. Daiwa Securities SMBC believes that such events as China's accession to the WTO and the upcoming Beijing Olympics in 2008 will prove to be seminal events in China's emergence as a world financial center.

To this end, the Daiwa Securities Group has signed a memorandum of understanding regarding business collaboration with the Shanghai International Group Corporation Limited ("SIG"). It is the intention of both parties to commence a study on business cooperation to establish a close relationship between the Daiwa Securities Group and the SIG Group with regards to securities-related businesses.

SIG, located in Shanghai, is a holding company of several financial and securities companies, with capital participation by the Shanghai Municipal People's Government. Daiwa Securities SMBC, together with Daiwa Institute of Research and SIG have reached a common understanding to speedily establish a

Overseas Ordinary Income

(Millions of Yen)

	America	Europe	Asia	Total
FY 2001	2,508	5,507	-173	7,842
FY 2000	11,254	5,233	810	17,297

cooperative relationship and to promote mutual development with respect to Chinese capital markets. During the initial stage, the companies will collaborate through exchange of information, including market research. In the future, ways will be investigated to extend the scope of business cooperation.

Risk Management in Daiwa Securities SMBC

At a Glance

Business

Manages risks associated with Daiwa Securities SMBC's participation in securities markets.

Market Position

Has been able to draw upon the knowhow of each of its parent companies, Daiwa Securities Group and the Sumitomo Mitsui Banking Corporation to construct an advanced risk-management framework.

Outlook

During FY 2002, measurement and control of operational risk will be enhanced.

Background

General Organization

Daiwa Securities SMBC, together with its affiliated overseas operations, are responsible for the Group's business in wholesale securities markets. These activities are intrinsically risk-bearing and include, as discussed before, the trading of equities, bonds and derivatives and principal investment in non-traditional asset classes. Risk management is thus a matter of importance for both Daiwa Securities SMBC and the Group as a whole.

The ultimate authority for risk management within Daiwa Securities SMBC lies with the Risk Management Committee, the members of which include the president, deputy presidents and directors of related departments. The committee meets on a quarterly basis to decide basic risk management policy and to set acceptable levels of credit, market and liquidity risk as part of an integrated risk management process.

A subcommittee of the Risk Management Committee meets monthly to consider details related to the implementation of stated policy and to consider the current profile of credit, market and liquidity risk. The members of this subcommittee are the general managers in charge of each product, marketing and administration activity of Daiwa Securities SMBC.

Day-to-day operations are handled by the Risk Management Department within Daiwa Securities SMBC, which bears responsibility for implementing policies related to market and credit risk. Liquidity risk is the responsibility of the Treasury Department. Market risk and liquidity risk are measured and reported daily to management by the Risk Management Department and the Treasury Department. Credit risk is reported to the director of the Risk Management Department on a weekly basis. Risk management is also taken up by the Executive Officer Meeting held weekly, with reports submitted to the Holding Company.

Since the formation of the Daiwa Securities Group in 1999, the risk management functions in Daiwa Securities SMBC have been significantly strengthened in a number of ways. In particular, marketing and trading departments now have independent middle offices responsible for risk management and which operate independently of the front offices.

The Risk Management Department, which is independent of the marketing and trading divisions

and has a separate reporting line, is responsible for overall control and monitoring of credit and market risk as well as settlement risk. It manages these risks in consultation with the middle offices mentioned earlier.

The Treasury Department also operates independently of the marketing and trading operations and has responsibility for ensuring availability of adequate funding and the management of liquidity risk.

Risk Measurement and Containment

Risk limits are set by category using the most appropriate measures for each asset class. These measures are supplemented by integrative measures centered on value at risk (VaR) which is used for measuring both market and credit risk.

These measures are supplemented by stress-testing, assuming sudden and serious dislocation to markets, which might call the validity of historical statistically derived measures into question. Specific scenarios used include those derived from historical experience, including dislocations seen during the time of the U.S. hedge fund crisis and Japan Premium as well as theoretical dislocations, including disruption to domestic repo markets.

The one area of Daiwa Securities SMBC's business that is not subject to the above management procedures is Daiwa Securities SMBC's own principal investment in non-traditional asset classes through Daiwa Securities SMBC Principal Investments. Investments in this category are difficult, if not impossible, to hedge adequately. However, the total position limit for this department has been set based on the requirement that Daiwa Securities SMBC be able to survive even if all such assets acquired become simultaneously worthless. In addition, the department exercises caution in pricing assets and practices active diversification of the portfolio as described earlier.

Consequently, Daiwa Securities SMBC believes the risk profile in this area to be acceptable.

Finally, Daiwa Securities SMBC has imposed measures to monitor and control market liquidity risk separately from market risk. This involves the imposition of restrictions on positions according to the size of the position and liquidity of the underlying instrument. These restrictions were imposed during FY 2001.

Contingency Plans

In addition to the above, Daiwa Securities SMBC has in place procedures to implement a phased reduction in position limits in response to a decline in its ability to access funds. In the most extreme case, positions would be reduced to within the limits of Daiwa Securities SMBC's long-term available funds and access to funds, such as commitment facilities granted by banks. Adjustments in allowable position were made following the recent credit rating downgrade experienced by Daiwa Securities SMBC.

Review

The influx of qualified staff from the Sumitomo Mitsui Banking Corporation, who have brought with them a great deal of advanced risk management knowledge, has reinforced risk management at Daiwa Securities SMBC.

In contrast to FY 2000, during FY 2001 Daiwa Securities SMBC's risk management profile was very benign. In fact, on a month-end VaR basis, total measured risk was confined to only a third of of the previous year. This partly reflects the poor state of the underlying markets during the year and partly stricter guidelines in respect of market liquidity risk imposed during the year.

Reflecting Daiwa Securities SMBC's commitment to continuous improvement in risk management, the number of staff employed rose from 30 at the beginning of the year to 38 in April 2002. These included a number of staff joining the department from the former Sakura Securities.

Outlook

The last several years have been devoted to the measurement and control of credit, market and similar risks. During FY 2002, Daiwa Securities SMBC will expend much effort in the identification and control of operational risk, including event risk where possible. In this, Daiwa Securities SMBC has benefited strongly from access to the risk management operations of the Sumitomo Mitsui Banking Corporation.

Value at Risk		(Billions of Yen)					
(Confidence level 99%; holding period 1 day)							
(Month-end)	3/2000	9/2000	3/2001	6/2001	9/2001	12/2001	3/2002
Equity	6.37	3.42	2.68	1.08	2.01	1.13	1.06
Interest	0.21	0.60	0.88	0.49	0.65	0.61	0.19
Currency	0.02	0.01	0.02	0.04	0.02	0.04	0.02
Total	6.60	4.03	3.58	1.61	2.68	1.77	1.27
Diversification benefit	-0.20	-0.51	-0.57	-0.40	-0.53	-0.38	-0.19
VaR	6.40	3.52	3.01	1.21	2.15	1.39	1.08